



## Special Edition for . . . State 457 Plan Participants

Montana Public Employee Retirement Administration (MPERA)

June 2002

### 457 Deferred Compensation Plan

#### Investment Options Determined

One of the biggest challenges to providing a successful 457 deferred compensation plan is determining the investment options to be offered and the proper *number* of those options. Investment advisors tend to believe that a large number of investment options within a plan **does not** result in better investing or diversification of investments by participants. Instead, too many investment options may result in confusion and lead to less diversification.

Appropriate diversification is critical to successfully weathering market cycles. Participants who do not have the time or the interest to fully investigate available options may end up investing in funds with similar objectives and underlying holdings, or may simply remain in the same fund or funds, regardless of performance.

#### Fund Options Studied

The Public Employees' Retirement Board (PERB) and the Employee Investment Advisory Council (EIAC) have continually wrestled with determining the proper number of investment options. For the past two years, PERB's outside independent consultant who annually reviews the 457 plan's mutual funds has commented that several funds in the plan replicate each other and, consequently, offer no additional value.

As a result, the EIAC and the PERB have studied the number and types of options within the plan. The study resulted in the PERB determining that a total of 21 funds in the following asset classes and categories will be offered effective May 1, 2003.

#### Funds Available May 1, 2003

- 1 stable value fund
- 2 bond funds:
  - 1 high yield and 1 corporate
- 2 balanced funds
- 4 large cap equity funds:
  - 1 value fund, 1 growth fund, 1 blend fund, and 1 index fund
- 2 mid cap equity funds:
  - 1 value fund and 1 growth fund
- 2 small cap equity funds:
  - 1 value fund and 1 growth fund
- 2 global funds:
  - 1 value fund and 1 growth fund
- 2 international funds:
  - 1 value fund and 1 growth fund
- 3 asset allocation funds

The above investment structure covers all asset classes and categories, thus giving participants the ability to diversify their investments and meet individual objectives and strategies.

**Implementation of this structure will result in several funds being discontinued effective May 1, 2003. The funds to be discontinued will be determined during next year's annual fund review. ?**

#### In This Issue

<i>Mutual Funds Annual Review</i> .....	2 - 3
<i>Time to Review Your Investment Strategy/Goals</i> .....	3
<i>Important Notice/Transaction Freeze Period</i> .....	3
<i>Stable Value Changes and Remains the Same</i> .....	4 - 5
<i>457 Deferred Compensation Plan Deferral Limits</i> .....	5
<i>Contacting MPERA and BenefitsCorp</i> .....	6

## Mutual Funds Annual Review

Each year, the Public Employees' Retirement Board (PERB), with the assistance of the Employee Investment Advisory Council (EIAC) and an outside independent consultant, reviews the mutual funds offered within the state 457 deferred compensation plan. The annual evaluation ensures the plan provides adequate and appropriate mutual fund investment options.

This year's annual evaluation was completed on April 25, 2002. Based upon the review and recommendations of the consultant and the EIAC, the PERB made the following decisions regarding the funds:

### 1 The following probationary funds will be discontinued:

#### Discontinued Funds

1. Bond Fund of America (bond fund)
2. Fidelity Advisor High Yield (bond fund)
3. Income Fund of America (balanced, value fund)
4. Putnam Voyager A (large cap, growth fund)
5. T. Rowe Price International (world stock, blend fund)

These discontinued funds failed to meet one or more of the established performance benchmarks for an extended period of time - one year or longer.

#### Performance Benchmarks

The established performance benchmarks are:

- the fund rate of return for the most current three-year period must meet or exceed the 50th percentile return of the Callan Associates universe of funds in the same asset class and investment category;
- the Sharpe Ratio Test for the most current three-year period must meet or exceed the 50th percentile Sharpe Measure of the Callan Associates universe of funds in the same asset class and investment category; and
- the fund must receive a Morningstar Category Rating of three stars (neutral) or higher for the most current three-year period.

#### Other Critical Indicators

In addition to determining if performance benchmarks are met, the PERB and EIAC review two other critical indicators:

- changes in fund category and investment objective; and
- changes in fund manager(s).

The discontinued funds will be closed to new participants effective June 14, 2002. They will be **fully closed** to existing participants and transfers on **Monday, September 16, 2002**.

Participants in any of the discontinued funds have until **Sunday, September 15, 2002**, to transfer their money to other investment options within the plan. Money remaining in the discontinued funds on Monday, September 16, 2002, will be automatically transferred to the stable value investment option.

### 2 The following new funds will be added:

#### New Funds

1. PIMCO Total Return (bond fund)
2. Columbia High Yield (bond fund)
3. TCW Galileo Select Equities (large cap, growth fund)
4. Artisan International Investors (world stock, blend fund)

The above funds will be added effective June 14, 2002, and will be available on that date for transfers of money from the discontinued funds.

(continued on page three)

(continued from page two)

### **3** The following funds will be placed on probation:

#### **Funds on Probation**

1. Dreyfus Premier Third Century (large cap, growth fund)
2. Putnam Investors A (large cap, growth fund)

These funds also failed to meet one or more of the established performance benchmarks listed on page two. Funds on probation will be reviewed quarterly. If performance improves and benchmarks are met, the fund(s) may be removed from probation. If performance does not improve or indicators warrant, the fund(s) may be discontinued and replaced with better performing fund(s) or with fund(s) that remain consistent with their fund category and investment objective. Participants will be notified prior to any fund being discontinued. ?

#### **For account information or to make changes . . .**

Use the **NEW** toll-free KeyTalk number:

**1-877-699-4015**

or the **NEW** web site:

**www.MPERAdcplans.com**

### **Time to Review Your Investment Strategy/Goals**

With new fund performance information, now is a good time to review your investment strategy/goals and asset allocation.

#### **For additional information or personal assistance . . .**

##### **Contact our third-party service provider:**

BenefitsCorp (Great-West Life & Annuity) in Helena

Phone: (406) 449-2408

Toll free: 1-800-981-2786

#### **For information on funds . . .**

Full fund data sheets for all funds offered in the plan can be found at the Montana Public Employee Retirement Administration (MPERA) website:

<http://www.discoveringmontana.com/doa/perb/>

If you do not have web access or would like a hard copy of the fund data sheets, please call the MPERA at:

Phone: (406) 444-3154

Toll Free: 1-877-275-7372

### **Important Notice/Transaction Freeze Period**

Starting at 2:00 p.m. MT, **Monday, September 16, 2002**, BenefitsCorp/Great-West Life & Annuity's systems (KeyTalk and Web site) will be closed to all inquiries and transactions from all participants.

This gives BenefitsCorp/Great-West the necessary time to transfer remaining account balances in discontinued funds, and to reconcile the transfers and all investment options. The freeze period ensures the integrity of the transfers, the systems, and your account balance. The systems will re-open on **Thursday, September 19, 2002**.

## Stable Value

*Changes and remains the same . . .*

**M**ost deferred compensation plan members may not have noticed, but some changes have taken place in the plan's stable value investment product. Some members noted the changes and wondered if the changes accounted for the decreased stable value yield. That's a fair question. A fair answer may be a little complex.

### Stable Value Fund Design:

In part, the complexity stems from the design of the stable value fund, which is more complicated than a normal mutual fund. Unlike a mutual fund, when you invest money in the stable value fund, a company guarantees you will get your money back as well as positive returns at a rate set by that company each quarter. This is the source of the stable value product. However, like all mutual funds, investment management and record keeping/administrative services must be provided.

### Request for Proposal (RFP):

The Department of Administration had used the Request For Proposals (RFP) process to choose investment and administrative service providers several times since 1975. When the legislature transferred deferred compensation plan administrative responsibility to the Public Employees' Retirement Board (the Board), the stable value investment management contract and

the record keeping/administration contract were expiring. To be assured the contracts for those services would be the best available, the Board determined that a RFP should be issued again.

### Record Keeping Contract:

As a result of the RFP process, Great West/Benefits Corp. again won a contract for record keeping and administrative services. Also, the company guaranteeing your investment and setting the crediting rate, AEGON, has not changed. So those aspects of the deferred compensation plan remain the same.

### Investment Manager Changed:

However, one noteworthy aspect of the stable value product did change as a result of the RFP process. Investment portfolio managers State Street Research (SSR) and the Montana Board of Investments (MBOI) were replaced by Pacific Investment Management Company (PIMCO). The MBOI and PIMCO proposals to manage the entire portfolio were the chosen finalists from the twelve written proposals submitted. After oral presentations to the Board, on a combined oral and written score, PIMCO was awarded the contract. The key

scoring criteria were net performance (yield minus expenses), safety of the investment in terms of portfolio diversity, and organizational experience and stability.

### Stable Value Fund Yield:

Both before and since PIMCO began investing for the stable value fund, the general level of interest rates in the bond market have been declining, which caused a decrease in the stable value fund yield. The interest rate decline was evident in a decrease in money market payout of over 3% during the last three fiscal quarters the stable value fund was managed by MBOI and SSR. The market decline affected the MBOI/SSR blended yield, which dropped from 6.827% to 5.899% during the same period. As a consequence, the AEGON crediting rate for the stable value fund during this period dropped from 7.1% to 6.2%.

*Unfortunately we are in a market environment that has led to declining interest rates, and the stable value fund has reflected that.*

### Management Responsibilities:

PIMCO assumed management responsibilities as the interest rates, and therefore the crediting rate, continued to decline. Moreover, PIMCO was asked to manage to a shorter average bond duration than the MBOI/SSR blend.

*(Stable Value continued on page 5)*

(Stable Value continued from page 4)

A shorter duration is typical for a stable value portfolio, which should track the market with limited time delay (particularly important when interest rates begin to rise again). But near term, this combination of lower interest rates and a shorter duration portfolio caused a slight dip in returns.

### **Stable Value Low Risk Vehicle:**

While MBOI and SSR have been good partners for the past five years, the Board is confident that PIMCO's investment strategy will also perform well relative to the market benchmarks. Unfortunately, we are in a market environment that has led to declining interest rates, and the stable value fund has reflected that. But the stable value product continues to be a low-risk vehicle for achieving reasonable returns as part of your diversified portfolio. ?

**Questions?  
Concerns?  
Contact the Board!**

If you have any questions or concerns, please contact the Board:

Phone: 444-3154 (in Helena)

Toll Free: 1-877-ASK-PERB  
(1-877-275-7372)

E-mail us at [mpera@state.mt.us](mailto:mpera@state.mt.us)

## **457 Deferred Compensation Plan Deferral Limits**

### **Deferral Limits:**

The deferral limit for the 457 Plan will be the lesser of 100% of compensation or the applicable dollar limit. The applicable dollar limit for 2002 is \$11,000. The limit will increase in \$1,000 increments each year until it reaches \$15,000 in 2006. After 2006, the limit will be indexed in \$500 increments.

### **Regular Catch-up Deferrals:**

Catch-up deferrals during the three years prior to normal retirement age may be twice the applicable dollar limit. The applicable dollar limit for 2002 is \$11,000. The catch-up deferral limit for this year is \$22,000. This limit will be increasing as the applicable dollar limit increases (explained above).

### **Additional Catch-up Deferrals:**

Individuals age 50 and older may make additional catch-up deferrals. These deferrals may be made except during the three years prior to normal retirement age when regular catch-up deferrals are being made. The limit for these deferrals is based on the deferral limit in effect for the past year for which the catch-up deferral is made.

### **Effective Date of Deferral:**

Beginning in February, 2002, a new deferral or any change to an existing deferral, such as an increase or decrease in the deferred amount, becomes effective no earlier than the first PAY PERIOD BEGINNING in the next calendar month following receipt of the written request. For example, a state employee's written request received in May will become effective the PAY PERIOD BEGINNING June 1, payday of June 26th.

### **For Information and to Make Changes . . .**

To obtain account information or make changes:

**Phone the NEW toll-free KeyTalk number.**



**1-877-699-4015**

**Use the NEW web site.**



**[www.MPERAdcplans.com](http://www.MPERAdcplans.com)**



## Need information?

### Contact the MPERA:

**MPERA**  
**100 North Park Ave, Suite 220**  
**PO Box 200131**  
**Helena MT 59620-0131**  
**Web Site: <http://www.discoveringmontana.com/doa/perb/>**

**Phone: 406-444-3154**  
**Toll Free: 1-877-275-7372**  
**Telefax: 406-444-5428**  
**E-mail: [mpera@state.mt.us](mailto:mpera@state.mt.us)**

### Contact BenefitsCorp:

**BenefitsCorp**  
**208 N. Montana Avenue**  
**Suite 202-B**  
**Helena MT 59601**  
**Web Site: <http://www.MPERAdcplans.com>**

**Phone: 406-449-2408**  
**Toll Free: 1-800-981-2786**  
**Telefax: 406-449-3306**

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